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IN THE

Supreme Court of the United States

No. 73-303

In the Matter of:

HALLMARK MEDICAL SERVICES, INC., ET AL.,

Debtors

WILLIAM A. MARTIN,

Trustee, Petitioner

v.

ISAAC MIZRAHI, STEPHEN CRAIR and HEIMAN AND CRARY, P.A.,

Respondents

REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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CITATIONS

CASES: Page

Dudley v. Mealy,
147 F.2d 268 (2d Cir. 1945) 4

Fosdick v. Schall,
99 U.S. 339 (1879) 1

Pusey and Jones Corp., In re,
192 F.Supp. 233 (D.Del. 1961), aff'd 295 F.2d 479 (3d Cir. 1961) 2

Richards, In re,
43 F.Supp. 733 (M.D.Pa. 1942) 3

Wood v. Guarantee Trust and Safe Deposit Co.,
128 U.S. 416 (1888) 1

Yale Express System, Inc., In re,
342 F.Supp. 972 (S.D.N.Y. 1972) 2, 3, 4

MISCELLANEOUS:

Analysis of H. R. 12889 Containing Amendments Proposed by the National Bankruptcy Conference Printed for the Use of the Committee on the Judiciary, House of Representatives (74th Congress, 2nd. Sess. 1936) 2

CITATIONS—Continued

Page

Supplemental Report of the Securities and Exchange Commission on Proposed Plan of Reorganization filed in *In re Yale Express System, Inc.*, 342 F.Supp. 972 (S.D.N.Y. 1972) 4

STATUTES:

48 Stat. 912 (1934) 2

§77 of Bankruptcy Act (11 U.S.C. §205) 2

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Respondents assert that the six months priority classification is applicable to the Chapter X reorganization of a private nursing home. (Resp. Brief at 7 *et seq.*). They ignore the fact that the "six months rule" was judicially created in, and limited to, a *railroad* receivership. *Fosdick v. Schall,* 99 U.S. 339 (1879). Thereafter, the United States Supreme Court reiterated that this rule *only* applied to *railroad* receiverships, emphasizing that a railroad is "a peculiar property . . . discharging a great public work." *Wood v. Guarantee Trust & Safe Dep. Co.,* 128 U.S. 416, 421 (1888). The decision below, which held that the rule could be applied to a private nursing home, is in direct conflict with those decisions.

Respondents further disregard the fact that the Chapter X priority provisions contain no such classification. Moreover, the legislative history of Chapter X establishes irrefutably that Congress intended no such classification.

Although Congress codified the "six months rule" in the statutes relating to railroad reorganizations,[1] it did not codify the rule when it enacted Chapter X. This omission was intentional. *In re Yale Express System, Inc.*, 342 F.Supp 972, 974 (S.D.N.Y. 1972).

The predecessor to Chapter X contained the "six months rule"[2] as did the original draft of Chapter X.[3] Nevertheless, in the ultimate enactment of Chapter X, Congress specifically struck such a priority classification.

The Fifth Circuit Court should not have countermanded that legislative prerogative.

Its decision to do so is in direct conflict with *In re Pusey and Jones Corp.*, 295 F.2d 479, 480-481 (3d Cir. 1961). There the Third Circuit Court flatly refused to create such a priority classification, stating that:

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[1] Section 77 of the Bankruptcy Act (11 U.S.C. 205).

[2] Section 77B of the Bankruptcy Act, (48 Stat. 912, 915 (1934)).

[3] *Analysis of H.R. 12889 Containing Amendments By the National Bankruptcy Conference Printed for the Use of the Committee on the Judiciary, House of Representatives* (74th Cong., 2d Sess. (1936)) at p. 74.

"The bankruptcy act has specific provisions concerning the order in which claims are arranged for distribution of a bankrupt's estate. We think it is undesirable to create a new class of creditors by judge-made rules which would transcend the provisions carefully worked out in the bankruptcy act. *If a new class of preferred creditors is to be established it should be done by the statute and not by ourselves.*" (Emphasis supplied).

Its decision is additionally in conflict with decisions holding the "six months rule" is only to be applied to a limited class of debtors, such as utilities or public transportation systems, where there is a compelling public interest in continuing uninterrupted a business that is public in character. (Pet. Brief at 10-11). An incisive description of the special nature of such debtors is provided in *In re Richards,* 43 F.Supp. 733, 734-735 (M.D.Pa. 1942):

"One of the chief differences between the operation of this debtor and a railroad is that, from a practical standpoint, it is virtually impossible to supply the same services which a railroad gives without using the property of the railroad acquired through eminent domain and improved at great expense. Hence, the public has a great interest in the continued operation of the facilities of the railroad which does not exist in an operation such as this debtor's, which can be duplicated without the

acquisition of property by eminent domain and without the investment of large sums of money and which is in fact duplicated by competitors at the present time."

Prior to the decision below, the only case extending the rule to other debtors in a Chapter X proceeding was *Dudley v. Mealy*, 147 F.2d 268 (2d Cir. 1945). That decision is an aberration. Indeed, it has been substantially disaffirmed in subsequent decisions in the same circuit.[4]

In view of the strong statutory interest of the Securities and Exchange Commission in Chapter X reorganizations (§208 of the Bankruptcy Act), it is significant that the Commission has vigorously opposed extension of the "six months rule." In *In re Yale Express System, Inc.*, 342 F.Supp. 972 (S.D.N.Y. 1972), the Commission urged that the rule could be applied only to railroads.[5] If, however, the rule was to be extended to other debtors, the Commission sought to have the rule limited to "electric companies, and enterprises such as street railway companies or bus companies which have the exclusive right to carry passengers over specified routes."[6]

By extending the "six months rule" to a private nursing home in Chapter X reorganization, the decision goes far beyond and conflicts with the pre-

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[4] *Johnson Fare Box Co. v. Doyle*, 250 F.2d 656 (2d Cir. 1958), *cert. den.* 357 U.S. 938 (1958); *In Re Yale Express System, Inc.*, 342 F.Supp. 972 (S.D.N.Y. 1972).

[5] *Supplemental Report of the Securities and Exchange Commission on Proposed Plan of Reorganization*, filed March 24, 1972, at 10, 13, (Appended to Petition for Rehearing below).

[6] *Id.* at 13.

viously cited decisions. This Court should resolve that conflict.

Respondents finally contend that this case will not be ripe for decision until the District Court has determined, on remand, whether the equities are with them. (Resp. Brief at 11). In fact, however, the "equities" issue was reached and resolved against Respondents by the District Court. (Pet. Brief at A-13).

There was a hearing before the Special Master for the classification of creditors, at which time Respondents made their oral claim of priority status. Respondents failed to tender evidence there to establish equity entitling them to priority status. Respondents again made no offer of evidence on this issue when afforded a second opportunity before the District Judge.[7]

Following the hearing, the Special Master found that:

> ". . . assuming but not deciding that the application of the said 'rule' could be discretionary, *the equitable considerations are not here present that might in some cases justify the exercise of any such discretion to create such a class of priority creditors.*" (Pet. Brief at A-17) (Emphasis supplied).

These findings were confirmed and adopted by the District Court. (Pet. Brief at A-13). The District Court's decision should be affirmed on this alternative ground even if the discretionary application of the rule were appropriate.

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[7] If there is a lack of evidence in this record to support Respondents' claim of equity, the fault lies solely with the Respondents themselves. They should not now be heard to complaint because they failed to present their case below.

CONCLUSION

There is no statutory authority for applying a six months priority classification in a Chapter X reorganization. The decision of the Fifth Circuit to do so thus raises an important federal question. Since claims of priorities arise in nearly every reorganization proceeding, this question should be resolved now in order to assure orderly disposition of reorganizations as mandated by the Bankruptcy Act.

Further, there is no judicial authority to apply the rule to debtors other than railroads, or at least, to public corporations such as utilities. The decision of the Fifth Circuit that the rule can be applied to a private nursing home conflicts with decisions of other Courts on this point.

The Special Master's exposure to this reorganization was more than minimal. The proceedings are in their third year. The docket consumes twenty pages, photo-reduced. The Special Master certainly had sufficient background to find, as he did, that the equities were not with Respondents.

The Petition for Writ of Certiorari should be granted.

Respectfully submitted,

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